Weekly Commentary with Professor Jeremy J. Siegel

Defying the Pessimistic Inflation Narratives

Monday, 4/15/2024

This past week contained an initial inflation panic, but cooler heads should prevail. Geopolitical tensions are on the rise again causing Brent Crude to breach $91 on Friday and simultaneously leading to a risk-off bid in bonds. But the bigger move in yields that cascaded into pressuring stocks was the Consumer Price Index (CPI) report.

The CPI's marginal excess over expectations, merely a tenth of a percent beyond the anticipated, prompted undue alarm. Over half of the core inflation hike is attributable to housing costs and insurance. We've talked at length about the distortions in BLS shelter and our own alternative calculations for shelter that average Zillow and Apartment List rent figures show shelter inflation of just 1.1% instead of 5.7%. When inputting that lower rent figure into CPI, that alone would bring inflation on both core and headline below 2%. The other key move higher was auto insurance.

Auto insurance rates, historically trailing behind auto prices by a year or more, are adjusting to the pandemic-induced surge in vehicle costs. Looking forward however, the stabilization in both used and new car prices foretells less pressure on inflation ahead. This contrast between retrospective and prospective data is stark here.

The Producer Price Index (PPI) brought back some tranquility, aligning with or slightly undercutting projections. March's Personal Consumption Expenditures (PCE) Price Index is also expected to reflect this subdued trend. Import prices conformed to forecasts, yet the University of Michigan inflation expectations have seen a slight uptick, likely swayed by current fuel prices and the CPI chatter. Nevertheless, this should be interpreted cautiously.

Employment figures, with jobless claims dipping to 210,000, again convey remarkable stability in the real economic figures. The upcoming retail sales data will be a critical gauge of March's economic activity. The Bloomberg Commodity Price Index has seen firmness, though the ongoing Middle Eastern tensions obscure whether it is more geopolitically driven or economic strength.

In a positive economic signal, bank deposits notably increased for the first time since interest rate interventions in 2022, suggesting a resurgence of liquidity which may bolster better growth. Gross domestic product (GDP) estimates for Q1 remain unchanged in the low two-percent range.

Within equities, growth stocks gained an edge over value stocks, reversing the traditional trend seen with rising interest rates being a hit on longer duration assets.

We are starting to get into earnings season and the financial sector, particularly large banking institutions, have demonstrated strength in anticipation of the earnings season, though expectations were very high and saw some sell-off post earnings on Friday. Initial indications suggest Q1 earnings will outperform current market expectations.

Many think the CPI data has shut off potential for a June decrease in the fed funds rate as they extrapolate the latest print. I am not ready to make that call. The economic landscape is dynamic, and we have two more CPI reports due before the Federal Reserve's June meeting. Consequently, any definitive statements regarding policy adjustments in June are premature.

In summary, the economic indicators are robust, and the initial earnings reports are promising. This suggests a sustained strength in the economy that could defy the more pessimistic inflation narratives.

Glossary

Bureau of Labor Statistics (BLS): A unit of the United States Department of Labor that measures labor market activity, working conditions, price changes, and productivity in the U.S. economy to support public and private decision making.

Consumer Price Index (CPI): A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living. Core CPI excludes food and energy costs.

Fed funds rate: The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the "policy rate" of the U.S. Federal Reserve.

Federal Reserve (Fed): The Federal Reserve System is the central banking system of the United States.

Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

Personal Consumption Expenditure (PCE) Price Index: A measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The core PCE Price Index measures the prices paid by consumers for goods and services without the volatility caused by movements in food and energy prices to reveal underlying inflation trends.

Bloomberg Commodity Price Index: A benchmark that tracks the price movements of commodity futures contracts on physical commodities.

Producer Price Index (PPI): A weighted index of prices measured at the wholesale, or producer level.

Yield: The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.